

State Notes

TOPICS OF LEGISLATIVE INTEREST

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Fiscal Implications of Dow Chemical and Midland Cogeneration Venture Property Tax Appeal Cases

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Two very large and protracted property tax appeal cases appear to be very close to being resolved and both of these cases will have adverse fiscal impacts on the School Aid Fund. These cases, both of which began in 1997, involve property located in the City of Midland and owned by Dow Chemical Company and the Midland Cogeneration Venture. Summaries of these two property tax appeal cases are presented below, along with information on the likely tax refunds that will have to be paid by the School Aid Fund and the affected local governments and school districts.

Dow Chemical Company Property Tax Appeal

In 1997, Dow Chemical Company appealed the assessed value assigned to its corporate headquarters and its Michigan Operations Plant, both located in Midland, Michigan. Since 1997, Dow Chemical amended its appeal several times to include the property assessments for tax years 1998 through 2006, although the current case includes only tax years 1997 through 2001. At issue were the true cash, assessed, and taxable values of these properties. Dow Chemical also contended that certain personal property was being assessed as both real and personal property and therefore was being subjected to double taxation. Given the complexity of determining the fair value for these properties, hearings and court dates were frequently delayed. Finally, the Michigan Tax Tribunal (MTT) established a schedule to divide the case into two phases: Phase I was to determine which assets were real property and which assets were personal property and Phase II was to determine the values of these properties.

Phase I of the case began in March 2006, and after the MTT met for 10 days, the hearing was adjourned and scheduled to be resumed on October 18, 2006. Just before the Phase I hearing was resumed, Dow Chemical Company and the City of Midland announced they had reached an agreement, so the October 18th hearing before the MTT was canceled. The proposed agreement, which includes the appeals for tax years 1997 through 2006, was approved by the Midland City Council on October 23, 2006, and is now before the MTT. If the Tribunal approves the tentative agreement, the City of Midland, Midland County government, Midland Public Schools, Delta College, and the State of Michigan will have 20 days to refund the amounts owed to Dow Chemical Company under the agreement.

Midland Cogeneration Venture Property Tax Appeal

In 1973, Consumers Power Company (now Consumers Energy Company) began construction of a nuclear power plant in Midland, Michigan. By 1984, the nuclear plant was still being constructed and for various reasons the project was abandoned. In 1987, the Midland Cogeneration Venture (MCV) was formed by Consumers Energy and Dow Chemical Company for the purpose of converting the abandoned nuclear plant into a gas-fired cogeneration plant. This plant was designed to use natural gas to generate both electricity and steam and it is currently the largest cogeneration plant in the nation. Consumers Energy established a long-term agreement to purchase power from the MCV.



In 1997, the MCV filed a property tax appeal with the MTT against the City of Midland for its 1997 property taxes. Subsequently, the MCV expanded the appeal to include its property taxes for the 1998 through 2006 tax years. The appeal was divided into two cases. A case involving tax years 1997 through 2000 was heard first and the case concerning tax years 2001 through 2006 is being held in abeyance. One of the key questions in this property tax appeal is whether the long-term power purchase agreement the MCV has with Consumers Energy should be included in a determination of the value of the MCV property. In January 2003, the MTT ruled that the power purchase agreement should not be considered in the property's valuation because the agreement is an intangible asset. As a result, the MTT ruled that MCV's property taxes were overstated for tax years 1997 through 2000.

The City of Midland appealed the decision to the Court of Appeals, and in early 2006 the Court of Appeals upheld the Tax Tribunal ruling; however, the Court did return the case to the Tribunal to clarify whether some tax-exempt pollution control equipment and some property located outside the City of Midland were included in the final true cash value figures used by the MTT in making its final decision. The City of Midland appealed the case to the Michigan Supreme Court, but on July 31, 2006, the Michigan Supreme Court issued an order denying the City of Midland's application for leave to appeal. The case is currently back before the MTT for the limited purpose of rectifying the final true cash value levels for the four tax years in question. Once the MTT finalizes this case, the affected parties will have 20 days to make the required refunds to the MCV.

Fiscal Impact – General Discussion, Dow Chemical, and MCV

General Discussion

When local nonhomestead taxable values are adjusted downward, the State faces both increased costs in the K-12 budget and reduced School Aid Fund (SAF) revenue. Turning to an explanation of the cost side, local school districts levy mills on nonhomestead property to generate a local portion of the districts' foundation allowances. The State (up to the State funding cap) finances the difference between a district's foundation allowance and what is generated (on a per-pupil basis) in local revenue by mills levied on nonhomestead property. Therefore, when the taxable value of nonhomestead property is reduced, the local millage revenue supporting a school district's foundation allowance falls and the State must pay more to ensure the district receives its full foundation allowance.

On the revenue side, all property, homestead and nonhomestead, is subject to the six-mill State education tax (SET). The revenue generated from this tax is deposited directly into the SAF, which is used to support K-12 appropriations. Therefore, when taxable values decline, the State millage revenue generated from the SET also declines.

The explanations above discuss only the State's fiscal implications when taxable values are reduced. Any local millage revenue, supporting such things as cities, townships, community colleges, or libraries, declines when a settlement, appeal, or decision reduces an entity's taxable value. Table 1 provides estimates of the local fiscal impacts, as well as State fiscal impacts for both the Dow Chemical and MCV (1997-2000) property tax appeal cases.



Dow Chemical Case

On October 18, 2006, the City of Midland and Dow Chemical announced a proposed settlement of the disputed taxable value case involving Dow Chemical's Midland manufacturing facility and corporate headquarters. As shown in Table 1, Dow Chemical will be refunded a total of \$35.1 million under the agreed to settlement. Of this amount, the School Aid Fund will have to pay \$15.4 million in FY 2006-07 due to a \$4.4 million refund of State Education Tax collections and an \$11.0 million increase in aid payments to make sure Midland Public Schools receives their full foundation allowance funding after they refund \$11.0 million in local school property taxes to Dow Chemical. Midland Public Schools also will have to refund \$2.6 million in interest penalties to Dow Chemical, which is not reimbursed by the State. The other affected local governments, including the City of Midland, will pay refunds totaling \$17.1 million and their respective refund amounts are broken out in Table 1. The MTT still must approve the settlement before it becomes effective.

MCV 1997-2000 Case

Turning to the MCV case (for the 1997-2000 time period), the MTT is finalizing all remaining issues. When resolution occurs, the impact will be on the FY 2006-07 budget. Assuming the Tribunal does not change the taxable values already settled upon, Table 1 illustrates the estimated repayments that will have to be made by the various taxing units affected by the decision.

Table 1

Estimated Payments to Dow Chemical and Midland Cogeneration Venture (MCV) Due to Property Tax Appeals for Tax Years 1997-2006 (Millions of Dollars)			
Taxing Unit	Dow Chemical 1997-2006	Midland Cogeneration Venture	
		1997-2000	2001-2006^{a)}
State: School Aid Fund – Expenditure Side.....	\$11.0	\$13.8	\$19.4
State: School Aid Fund – Revenue Side.....	4.4	5.8	7.0
Local: City of Midland.....	9.0	12.1	17.0
Local: County of Midland.....	5.6	7.8	11.0
Local: Midland Public Schools	2.6	4.1	2.0
Local: Midland County Education Service Area (ISD)	0.8	1.1	1.5
Local: Delta Community College.....	1.7	2.0	2.8
Total.....	\$35.1	\$46.7	\$60.7

^{a)} Senate Fiscal Agency estimates, except for State: School Aid Fund - Expenditure and Revenue Sides and Local: Midland Public Schools.

Source: City of Midland and Midland Public Schools

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As shown in Table 1, the estimated reduction in State SAF revenue is \$5.8 million, and the estimated additional cost to the State to offset reduced local millage revenue supporting Midland Public Schools' foundation allowance is \$13.8 million. These two occurrences total a \$19.6 million cost to the State's FY 2006-07 K-12 budget for the first MCV case alone.

Also shown in Table 1, Midland Public Schools will face an additional expense that will not be reimbursed by the State, namely interest costs on the overcollections from the 18-mill levy on the MCV's taxable value. Those costs for the 1997-2000 case are estimated at \$4.1 million. The Midland Area Intermediate School District is facing an estimated \$1.1 million in costs, and Delta Community College is estimated to owe \$2.0 million to the MCV. Finally, the City of Midland will pay approximately \$12.1 million to the MCV as a result of this decision.

MCV 2001-2006 Case

Turning to the MCV case covering 2001 to the present, and using the estimates provided by the Midland Public Schools and the Senate Fiscal Agency, the second MCV tax case will cost a total of \$60.7 million. Of this amount, the School Aid Fund cost will total \$26.4 million, of which \$7.0 million reflects the estimated overcollection of the SET and \$19.4 million is due to the increased State contribution to Midland Schools' foundation allowance. This case has not been settled, and therefore it is unknown when it will affect the State budget.

Conclusion

Combining the fiscal impacts for the Dow Chemical and MCV cases, the FY 2006-07 K-12 budget will face an estimated \$35.0 million in reduced revenue and increased costs, due to the proposed resolution on the Dow Chemical case and the Tax Tribunal's decision on the first Midland Cogeneration Venture case. Another case is pending before the Tribunal – the MCV case covering the time period from 2001 to the present. While it is unknown when the second MCV case will be resolved, if it is settled yet this fiscal year, then the total cost to the School Aid Fund in FY 2006-07 would increase to an estimated \$61.4 million.